

# Income Tax Return for an S Corporation

## General Instructions

For assistance, please contact one of the Taxpayer Information and Assistance numbers:

Phoenix ..... (602) 255-3381  
 Tucson ..... (520) 628-6421  
 Other Arizona areas ..... 1-800-352-4090  
 Form Orders ..... (602) 542-4260  
 Forms by Fax ..... (602) 542-3756  
 Recorded Tax Information  
     Phoenix ..... (602) 542-1991  
     Other Arizona areas .... 1-800-845-8192  
 Hearing impaired TDD user  
     Phoenix ..... (602) 542-4021  
     Other Arizona areas .... 1-800-397-0256

## Who Must Use Form 120S

Corporations taxed as S corporations under Subchapter S of the Internal Revenue Code must file Form 120S.

## Taxable Year Covered by Return

The S corporation must have the same taxable year for Arizona purposes as it has for federal purposes. The S corporation must file the return on a calendar year basis (for 1995) or on a fiscal year basis (for years ending in 1996). Indicate the period covered by the taxable year on page 1 of the return and whether the taxable year is a calendar year or a fiscal year.

## Filing Original Returns

Returns are due by the 15th day of the third month following the close of the taxable year. If the taxpayer has a valid federal or Arizona extension, file the return by the extended due date. Attach a copy of the federal or Arizona extension to the front of the Arizona return. Send the return to the Department of Revenue, PO Box 29079, Phoenix AZ 85038-9079. The president or other principal officer and the treasurer or chief accounting officer must both sign the return. Attach a copy of the completed federal Form 1120S to the Arizona return.

The department normally determines the timeliness of a return by the postmark or

other official mark of the U.S. Postal Service stamped on the cover in which the return is mailed. Refer to Arizona General Tax Ruling GTR 93-1 for further information. Call one of the Taxpayer Information and Assistance numbers listed above to obtain a copy of the tax ruling.

## Filing Amended Returns

Any taxpayer who files an amended return with the Internal Revenue Service must file an Arizona amended return. The taxpayer must report changes or corrections of the taxpayer's income by the Internal Revenue Service. The taxpayer must also report changes in the taxpayer's income as the result of renegotiations of a contract or subcontract with the United States to the department. The taxpayer must report the change or correction or file an amended return to the department within 90 days after the final determination of the change or correction.

File amended returns within four years after the filing of the original return. Attach a statement to the amended return that explains why the taxpayer amended its Arizona return. If the taxpayer amended its federal return, attach a copy of the amended federal return with all applicable schedules to the amended Arizona return.

*NOTE: File amended returns for prior taxable years on the Arizona Forms 120S for those taxable years. Use the 1995 Form 120S to amend only the 1995 taxable year.*

## Payment of Tax

If the S corporation itself is subject to tax, the entire amount of tax is due by the original due date of the return; however, see *Extension Of Time To File A Return* for exceptions.

The S corporation is subject to tax only if it has income subject to tax at the corporate level on the federal Form 1120S. The income subject to tax at the corporate level is excess net passive

income, capital gains income, or certain built-in gains income.

## Estimated Tax Payments

S corporations that expect an Arizona income tax liability for the taxable year of \$1,000 or more must make Arizona estimated tax payments. Use Form 120ES, Corporation Estimated Tax Payment.

For exceptions to the estimated tax requirements, see the instructions for Form 220, Underpayment of Estimated Tax by Corporations.

*NOTE: The Arizona estimated tax payment calculation should include any tax from the recapture of the environmental technology facility and recycling equipment credits. Include the correctional industries recapture tax, if applicable, in the Arizona estimated tax payment calculation. These requirements apply whether or not the S corporation itself is subject to tax at the corporate level.*

An S corporation that fails to make the required estimated tax payments is subject to a penalty plus interest on any estimated tax payment which is late or underpaid.

The Arizona required annual payment of corporate estimated tax for an S corporation is the smaller of:

1. Ninety percent of the taxpayer's Arizona tax liability for the current taxable year, or
2. An amount equal to the sum of:
  - a. ninety percent of the portion of the current taxable year's Arizona tax liability that is attributable to built-in gains income or certain capital gains income.
  - b. one hundred percent of the portion of the prior taxable year's Arizona tax liability that is attributable to excess net passive income.

*NOTE: In order for the taxpayer to base its estimated tax payments on the tax liability described in (2) above, the taxpayer's return filed for the prior taxable year must have been for a period of twelve months.*

Taxpayers required to make Arizona corporate estimated tax payments should use the 1996 Form 120ES Worksheet to compute the required installments. Refer to the 1996 Form 120ES Worksheet and its instructions before completing the 1996 Form 120ES.

Effective for taxable years beginning on or after January 1, 1994, certain taxpayers must make estimated tax payments via the electronic funds transfer program. Taxpayers whose Arizona corporate income tax liability for the preceding taxable year was \$50,000 or more must make Arizona corporate estimated tax payments via electronic funds transfer. If the taxpayer is making its estimated tax payments by electronic funds transfer (EFT), the taxpayer should not submit the Arizona Form 120ES to the department.

Obtain additional information concerning the Arizona electronic funds transfer program by contacting the EFT Help line at 1-800-572-7037 (542-2040 in Phoenix). The FAX line is (602) 542-4667.

## Extension of Time To File a Return

The S corporation can apply for an Arizona extension by filing a completed Arizona Form 120EXT by the original due date of the return. The S corporation can use a valid federal extension rather than applying for an Arizona extension. The Form 120EXT must be used to transmit any extension payments, whether the S corporation uses a valid federal extension or requests an Arizona extension. Attach a copy of the federal or Arizona extension to the front of the Arizona return.

The S corporation must pay **90** percent of the tax liability by the original due date of the return. The S corporation's tax liability may be the \$50 minimum tax or may include the correctional industries recapture tax. The tax liability may also

include tax from the recapture of the environmental technology facility and recycling equipment credits. The department imposes the extension underpayment penalty on any late or underpaid extension payments.

The department grants Arizona extensions for a period of six months. Arizona law provides that six months is the maximum extension of time to file that the department may grant. However, Arizona law provides that the department may accept the federal extension for the same period as covered by the federal extension.

## Penalties and Interest

**A. Late Filing Penalty.** A return filed after the original due date is subject to the late filing penalty unless the S corporation has a valid federal or Arizona extension. The S corporation must attach a copy of the valid federal or Arizona extension to the return. A return filed after its extended due date is also subject to the late filing penalty. The late filing penalty is **5** percent of the tax found to be remaining due. The penalty period is for each month or fraction of a month between the due date of the return and the date the S corporation filed the return. The maximum penalty is **25** percent of the tax found to be remaining due.

**B. Extension Underpayment Penalty.** A return filed without an attached valid federal or Arizona extension is subject to the extension underpayment penalty. The S corporation must pay **90** percent of the tax liability disclosed by its return on or before the original due date of the return. The department imposes the extension underpayment penalty on any late or underpaid extension payments. The extension underpayment penalty is one-half of one percent (**.005**) of the tax not paid. The penalty period is for each 30-day period or fraction thereof between the original due date of the return and the date the S corporation paid the tax. The maximum penalty is **25** percent of the tax not paid.

**C. Late Payment Penalty.** The department imposes the late payment penalty on tax not paid by the date prescribed for its payment. The late payment penalty is **10**

percent of the tax not paid within the time prescribed for its payment.

*NOTE: If two or more of the penalties described in A, B, or C above apply, the maximum combined penalty is **25** percent.*

**D. Interest.** The department assesses interest on any portion of the tax, whether determined by the department or the taxpayer, not paid by the date prescribed for its payment. The department applies the rate of interest, compounded annually, in the same manner and at the same time as prescribed by Internal Revenue Code § 6621. On January 1 of each year, the department adds any interest outstanding as of that date to the principal amount of the tax. It is then a part of the principal amount of the tax and accrues interest until paid.

**E. Underpayment of Estimated Tax Penalty.** The department imposes the underpayment of estimated tax penalty on any late payment or underpayment of a required installment of estimated tax. Refer to Arizona Form 220 for further details. The penalty imposed is the penalty prescribed by ARS § 43-582 for the applicable period.

## Furnishing Data

S corporations must attach a copy of the federal return (along with all schedules and attachments) to the Arizona return.

Do not send in a blank Arizona return with a copy of the federal return; the return will not process accurately. The taxpayer must furnish complete data. Answer all questions on the return. Complete all applicable schedules. Also attach all appropriate supplementary schedules.

## Records

Every S corporation should maintain books and records substantiating information reported on the return and keep these documents for inspection.

## IRC § 7519 Required Payments

Taxpayers cannot deduct the federal required payments on their Arizona tax returns as an ordinary and necessary business expense or otherwise.

## Rounding Dollar Amounts

Taxpayers may round amounts to the nearest whole dollar. If 50 cents or more, round up to the next dollar. If less than 50 cents, round down.

## Line-by-Line Instructions

Type or print the required information in the name, address, and information boxes on the top of page 1.

Enter the S corporation's federal employer identification number, which is the taxpayer identification number (TIN). Enter the Arizona withholding tax number and Arizona transaction privilege tax number for the S corporation. Indicate whether this return is an original or an amended return.

All returns, statements, and other documents filed with the Department of Revenue require a taxpayer identification number (TIN). The TIN is either a correct social security number or, for a business, the federal employer identification number. Paid tax preparers must also include their TIN on forms where requested. Taxpayers and paid preparers who fail to include the proper TIN may be subject to a penalty. Please check the return to be sure that all required identification numbers are accurate and written clearly. Missing, incorrect, or unclear identification numbers may cause delays in processing the returns.

### Line 1 - Distributive Income (Loss)

Enter the net total of distributive income (loss) and expense (from federal Form 1120S, Schedule K).

### Line 2 - Excess Net Passive Income

Enter the amount of excess net passive income from the federal worksheet included in the instructions for Form 1120S. (Refer to the instructions for the

computation of the excess net passive income tax in the federal Form 1120S.)

### Line 3 - Capital Gains/Built-in Gains

Enter the amount of capital gains income or certain built-in gains income which was subject to tax on federal Form 1120S. (Refer to the instructions for the computation of the tax from federal Form 1120S, Schedule D.)

### Line 4 - Total Federal Income Subject to Corporate Income Tax

Add lines 2 and 3. Enter the total.

### Lines 5 through 10 - Multistate S Corporations Only

Any S corporation that has income from business activity that is taxable both within and without Arizona must allocate and apportion its net income. The S corporation must allocate and apportion its net income according to the Uniform Division of Income for Tax Purposes Act (UDITPA), ARS §§ 43-1131 through 43-1150. An S corporation that has income from business activity taxable in more than one state is a "multistate S corporation". An S corporation that has income from business activity that is taxable entirely within Arizona is a "wholly Arizona S corporation".

Wholly Arizona S corporations - do not complete lines 5 through 10. Go to line 11. Multistate S corporations - refer to the instructions for Schedule C for more detailed information before completing these lines. Do not enter an amount on page 1, line 7, before reading the instructions for Schedule C. The taxpayer must carry out the decimal on line 7 to six places.

### Line 5 - Nonapportionable or Allocable Income

The taxpayer must apportion all business income by the use of the apportionment formula. Nonbusiness income is nonapportionable and specifically allocable to a particular state.

The taxpayer should attach a schedule that details the amount of nonapportionable income subtracted on page 1, line 5.

"Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business. Business income includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. (ARS § 43-1131) "Nonbusiness income" means all income other than business income. (ARS § 43-1131)

Enter the total amount of all income (or loss) which is nonapportionable or specifically allocable to Arizona. Refer to ARS §§ 43-1134 through 43-1138 for the methods of allocating certain types of nonbusiness income.

### Line 6 - Apportionable Income

Subtract line 5 from line 4 and enter the result. This is the amount of income subject to apportionment.

### Line 7 - Arizona Apportionment Ratio

Compute the apportionment factors according to the instructions for Schedule C. Enter the average ratio amount from Schedule C, line C5, column (c) on page 1, line 7. The taxpayer must carry out the decimal on line 7 to six places.

### Line 8 - Income Apportioned to Arizona

Multiply line 6 by line 7 and enter the result. This is the amount of income apportioned to Arizona.

### Line 9 - Other Income Allocated to Arizona

Enter the total amount of all income (or loss) which is specifically allocable to Arizona. ARS §§ 43-1134 through 43-1138 specify the methods for allocating certain types of income to Arizona. Do not include the amount of any nonbusiness income which is allocable to another state on this line. The taxpayer should attach a schedule that details the amount of income that is allocable to Arizona.

**Line 11 - Arizona Income Before Taxes**

Wholly Arizona S corporations - enter the amount from line 4 here. Multistate S corporations - enter the amount from line 10 here.

**Line 12 - Arizona Income Tax**

All S corporations must compute the Arizona tax on an accrual basis. S corporations cannot compute the Arizona tax on a cash basis.

S corporations that do not have tax from the recapture of tax credits AND are not claiming tax credits - enter the Arizona tax accrued in the Schedule B worksheet on Arizona Form 120S, page 2. The amount entered on page 1, line 12, must equal the amount of Arizona tax computed for page 1, line 14.

S corporations that have tax from the recapture of tax credits OR are claiming tax credits - enter the tax computed on the Schedule B worksheet in the instructions for Schedule B. The amount entered on page 1, line 12, must equal the tax liability computed for page 1, line 21.

**Line 14 - Arizona Tax**

The S corporation is subject to the tax computed on line 14 only if it has income subject to tax at the corporate level on the federal Form 1120S. The income subject to tax is excess net passive income, capital gains income, or certain built-in gains income. (These amounts are entered on page 1, lines 2, and 3.)

The amount of the tax is the greater of \$50 or 9 percent of the net income subject to Arizona corporate income tax (line 13). The S corporation is subject to the \$50 minimum tax if it has income subject to tax at the federal level, although line 13 may be zero or a negative amount.

Multiply the net income subject to Arizona corporate income tax (page 1, line 13) by 9 percent. If the computed amount of tax is less than \$50, enter the minimum tax of \$50.

**Line 15 - Tax From Recapture of Environmental Technology Facility Credit and Recycling Equipment Credit**

Enter the amount of tax due from the recapture of the environmental technology facility credit and/or recycling equipment credit from Form 300, Part II, Line 18.

**Line 16 - Subtotal**

Add lines 14 and 15. This is the amount of tax liability to which the total amount of tax credits claimed by the taxpayer may be applied.

**Line 17 - Tax Credits**

Enter the allowable tax credit amount from Arizona Form 300, Part II, line 33. This amount cannot be larger than the amount on line 16 of this form.

1. Defense Contracting Credit. There are two tax credits for qualified defense contractors. Qualified defense contractors may claim a tax credit for net increases in employment positions under United States Department of Defense contracts and in private commercial employment positions. There is also a tax credit for property taxes paid by a qualified defense contractor. Complete Arizona Form 302 to claim these tax credits.
2. Enterprise Zone Credit. Businesses located in an enterprise zone established under Arizona law may claim a tax credit for net increases in employment of qualified employees. Such businesses may also claim a tax credit for net increases in employment of dislocated workers. Complete Arizona Form 304 to claim this tax credit.
3. Environmental Technology Facility Credit. This credit is for costs incurred in constructing a qualified environmental technology manufacturing, producing, or processing facility as described in ARS § 41-1514.02. Complete Arizona Form 305 to claim this tax credit.

4. Military Reuse Zone Credit. This tax credit is for net increases in employment of full-time employees working in a military reuse zone established under Arizona law. The employees must primarily engage in manufacturing, assembling, or fabricating aviation or aerospace products. Complete Arizona Form 306 to claim this tax credit.

5. Recycling Equipment Credit. This tax credit is for corporate taxpayers who place recycling equipment in service in Arizona. Recycling equipment is new or used equipment purchased during the taxable year and used exclusively to process post-consumer select solid waste materials. Recycling equipment is also manufacturing machinery used exclusively to produce finished products, the composition of which is at least 25 percent post-consumer select solid waste materials. Complete Arizona Form 307 to claim this tax credit.

6. Research and Development Expenses Credit. This is a tax credit for corporate taxpayers who incur qualified research expenses for research conducted in Arizona. The credit applies to qualifying expenses incurred after December 31, 1993. The law provides no carryforward for this credit. Complete Arizona Form 308 to claim this tax credit.

7. Correctional Industries Credit. The allowable credit is for the investment in qualified property on the grounds of an Arizona correctional facility. The allowable credit is also for the employment of inmates in the Arizona correctional facility or for the employment of inmates in prison construction (for an Arizona correctional facility). The law provides no carryforward for this credit. Complete Arizona Form 311 to claim this tax credit.

8. **Agricultural Water Conservation System Credit.** This tax credit is for expenses incurred during the taxable year to purchase and install an agricultural water conservation system in Arizona. The credit applies to taxable years beginning from and after December 31, 1993. Complete Arizona Form 312 to claim this tax credit.

9. **Alternative Fuel Vehicles And Equipment Credit.** This tax credit is for the purchase of new alternative fuel vehicle(s) or expenses incurred for the conversion of conventional vehicle(s), or the purchase of alternative fuel delivery system(s) for use in Arizona. The credit applies to taxable years beginning after December 31, 1993, and before January 1, 1999. Complete Arizona Form 313 to claim this tax credit.

10. **Underground Storage Tanks Credit.** This tax credit is for expenses incurred by a corporate taxpayer not liable or responsible for corrective actions required due to the release of a regulated substance. The credit applies to taxable years beginning from and after December 31, 1993. There is no carryforward allowed for this tax credit. Complete Arizona Form 314 to claim this tax credit.

11. **Pollution Control Credit.** This new tax credit is for expenses incurred during the taxable year to purchase real or personal property used in the taxpayer's trade or business in Arizona to control or prevent pollution. The credit applies to taxable years beginning from and after December 31, 1994. Complete Arizona Form 315 to claim this tax credit.

12. **Construction Materials Credit.** This new tax credit is for new construction materials incorporated into a qualifying facility located entirely within Arizona, construction of which is begun on or after January 1, 1994, and completed on or before December 31, 1999. The credit shall be claimed in the taxable year in which the qualified facility receives a certificate of occupancy. Complete Arizona Form 316 to claim this tax credit.

13. **Summer School and Jobs Credit.** This new tax credit is for wages paid to students enrolled in the 1995 summer school and jobs program. The law provides no carryforward for this credit. Complete Arizona Form 317 to claim this tax credit.

Complete the appropriate credit forms for each credit. Attach the completed credit forms to the corporate return with the Arizona Form 300.

### Line 18 - Credit Type

Indicate which tax credits were claimed on line 17 by writing the applicable form number(s) in the space provided.

If you are claiming:	Write form number:
1. Defense Contracting Credit	302
2. Enterprise Zone Credit	304
3. Environmental Technology Facility Credit	305
4. Military Reuse Zone Credit	306
5. Recycling Equipment Credit	307
6. Research and Development Expenses Credit	308
7. Correctional Industries Credit	311
8. Agricultural Water Conservation System Credit	312
9. Alternative Fuel Vehicles and Equipment Credit	313
10. Underground Storage Tanks Credit	314
11. Pollution Control Credit	315
12. Construction Materials Credit	316
13. Summer School and Jobs Credit	317

### Line 19 - Subtotal

Subtract line 17 from line 16. Line 19 cannot be a negative amount.

### Line 20 -

#### Correctional Industries Recapture Tax

Enter the amount from Arizona Form 300, Part II, line 34.

*NOTE: Correctional industries recapture tax cannot be offset by commercial tax credits. An S corporation that is subject to the correctional industries recapture tax, but does not have federally taxed income, must complete this line by entering the amount of the correctional industries recapture tax here.*

### Line 22 - Extension Payments

Enter any payment made with the request for extension of time to file the income tax return. Attach a copy of the Form 120EXT to the front of this return.

### Line 23 - Estimated Payments

Enter the total paid by the corporation on Form 120ES for the taxable year. Attach a schedule listing dates and payments made.

### Line 24 - Total Payments

Original Returns: Add lines 22 and 23 and enter the total.

Amended Returns: Enter the amount from the latest of the following. (1) The amount from line 21 of the original return. (2) The amount from line 21 of a previous amended return. (3) The corrected tax amount from a Department of Revenue correction notice.

### Line 25 - Balance of Tax Due

If the amount on line 21 is **larger** than the amount on line 24, there is a balance of tax due. Subtract line 24 from line 21 and enter the difference.

### Line 26 - Overpayment of Tax

If the amount on line 24 is **larger** than the amount on line 21, there is an overpayment of tax. Subtract line 24 from line 21 and enter the difference (as a positive number).

**Line 27 - Penalty and Interest**

Calculate any penalty and interest due as a result of late filing or late payment of tax. Calculate interest on the amount shown on line 25 at the prevailing rate. The interest period is from the original due date of the return to the payment date. See "Penalties and Interest" section, page 2 of the instructions.

Do not include or enter the amount from Arizona Form 220.

**Line 28 - Underpayment of Estimated Tax Penalty and Interest**

If the Arizona tax liability is \$1,000 or more, the taxpayer must complete the Form 220 whether or not it is subject to a penalty.

Complete Arizona Form 220, Underpayment of Estimated Tax by Corporations, in order to determine the amount of any penalty and interest due with the original return. Enter the total penalty and interest from Form 220, Part D, line 16. Attach the completed Form 220 to the original return **and** check the box on line 28.

The department assesses a penalty if the taxpayer does not attach the completed Form 220 and check the box on line 28 of the original Form 120S.

**Line 29 - Total Due**

If the taxpayer had a balance of tax due on line 25, add lines 25, 27, and 28, and enter the total on line 29. This is the total amount due. Pay this amount when the

taxpayer files the return. Make the check payable to the Arizona Department of Revenue and include the taxpayer's TIN on the check.

**Line 30 - Overpayment**

If the taxpayer had an overpayment of tax on line 26, subtract the total of line 27 and line 28 from line 26. Enter a positive difference on line 30. This is the total overpayment. If the difference is negative, enter the difference as a positive number on line 29.

**Line 31 - Overpayment Applied to Estimated Tax**

The taxpayer may apply part or all of an overpayment reported on line 30 as a 1996 estimated tax payment. Enter the applicable amount on line 31.

**Line 32 - Refund**

Subtract line 31 from line 30 and enter the result. This is the net refund amount.

**Schedule A - Additional Information**

Answer all questions as accurately and completely as possible.

**Schedule B - Arizona Tax Deduction**

S corporations that do not have tax from the recapture of tax credits AND are not claiming tax credits - use the Schedule B worksheet on Arizona Form 120S, page 2, to compute the Arizona tax deduction (page 1, line 12). The Arizona tax

deduction computed for page 1, line 12, must equal the tax computed for page 1, line 14.

Do not complete the Schedule B worksheet on Arizona Form 120S, page 2, if the amount entered on page 1, lines 2 and 3, is zero.

Example - Taxpayer X had Arizona income of \$20,000 before the Arizona tax deduction.

**Schedule B Example**

Line B1	\$ 20,000.00
Line B2	<u>X</u> 0.09
Line B3	1,800.00
Line B4	÷ 1.09
Line B5	\$ 1,651.38

S corporations that have tax from the recapture of tax credits OR are claiming tax credits - use the Schedule B worksheet in the following instructions to compute the Arizona tax deduction (page 1, line 12). **DO NOT COMPLETE THE SCHEDULE B WORKSHEET ON ARIZONA FORM 120S, PAGE 2.** The Arizona tax deduction computed for page 1, line 12, must equal the tax liability (page 1, line 21). S corporations that have tax from the recapture of tax credits OR are claiming tax credits must complete Arizona Form 300 before completing the Schedule B worksheet in the instructions.

Do not complete the Schedule B worksheet in the instructions if the amount entered on page 1, lines 2 and 3, is zero.

B1	Arizona income before taxes - from page 1, line 11 .....	B1	_____
B2	Arizona tax rate .....	B2	<u>.09</u>
B3	Subtotal: multiply line B1 by line B2 (if less than \$50, enter the minimum tax of \$50).....	B3	_____
B4	Tax from recapture of tax credits - from Form 300, Part II, line 18.....	B4	_____
B5	Subtotal: add lines B3 and B4 .....	B5	_____
B6	Tax credits - from Form 300, Part II, line 33 .....	B6	_____
B7	Subtotal: subtract line B6 from line B5 .....	B7	_____
B8	Recapture tax - from Form 300, Part II, line 34 .....	B8	_____
B9	Subtotal: add line B7 and line B8 .....	B9	_____
B10	1 plus the tax rate - line B2.....	B10	<u>1.09</u>
B11	Tentative Arizona tax deduction - line B9 divided by line B10.....	B11	_____
B12	Line B1 minus line B11 - If less than zero, enter 0.....	B12	_____
B13	Arizona tax deduction - If line B12 is less than or equal to \$555.56, enter the total of the \$50 minimum tax plus line B4 minus line B6 plus line B8. If line B12 is greater than \$555.56, enter the amount from line B11. In either case, the amount entered cannot be less than line B8. Enter the applicable amount here and on page 1, line 12. This should equal the tax liability computed for page 1, line 21. ....	B13	_____

## Schedule C - Apportionment Formula (Multistate S Corporations Only)

ARS §§ 43-1131 through 43-1150 govern the apportionment of income. An S corporation that engages in activities both within and without Arizona must apportion its business income. The S corporation must base the apportionment on property, payroll, and sales in Arizona as compared with everywhere. "Everywhere" means the property, payroll, and sales factors related to the whole unitary business.

When the taxpayer uses the apportionment method, complete page 1, lines 5 through 10.

ARS § 43-1148 provides administrative relief if the allocation and apportionment provisions of UDITPA do not fairly represent the extent of the taxpayer's business activity in this state. The taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

1. Separate accounting.
2. The exclusion of any one or more of the factors.
3. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state.
4. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

This section permits a departure from the allocation and apportionment provisions only in limited and specific cases. ARS § 43-1148 may be invoked only in specific cases where unusual fact situations produce incongruous results under the apportionment and allocation provisions.

Taxpayers seeking such relief should submit a letter to the Corporate Income Tax Section 60 days prior to the filing of the return setting forth the relief that is requested and the justification for the relief.

The department normally makes such determinations only upon audit of the taxpayer. Such a detailed examination of the specific facts and circumstances reveals whether such unusual fact situations and incongruous results exist.

*NOTE: ARS § 43-1139 (Allocation of business income) provides that the apportionment ratio is a fraction. The numerator of the fraction is the property factor plus the payroll factor plus two times the sales factor. The denominator of the fraction is four.*

### Line C1 - Property Factor

The value of tangible personal property and real property owned by the taxpayer is its original cost. The taxpayer normally determines the average value of its owned property by averaging the values at the beginning and ending of the tax period.

The value of tangible personal property and real property rented by the taxpayer is eight times its net annual rental rate. The net annual rental rate is the annual rental rate paid by the taxpayer for rented property less the aggregate annual subrental rates paid by subtenants of the taxpayer. The taxpayer automatically achieves averaging for rented property by the method of determining the net annual rental rate of such property.

Report real property situated and tangible personal property permanently located in Arizona, if connected with the business, as property within Arizona. Allocate the value of mobile property to Arizona based on the total time that the property was within Arizona.

### Line C2 - Payroll Factor

Report salaries, wages, or other compensation of officers, employees, etc., as within Arizona, if performance of the services occurs here. This rule applies regardless of where payment is made or control exercised. This rule also applies regardless of whether the performance of the services is partly or wholly in connection with the apportionable business carried on outside the state or in interstate or foreign commerce. Allocate the compensation of officers and employees who perform services partly

within and partly without Arizona to this state when:

1. The services performed outside of Arizona are incidental to the employee's service within Arizona; or
2. The employee's base of operation is in Arizona; or
3. The employee has no base of operation in any state but the direction or control of the employee is from Arizona; or
4. The employee has no base of operation in any state and there is no direction or control from a state in which the employee performs some part of his services, but the employee's residence is in Arizona.

### Line C3 - Sales Factor

The term "sales" includes all gross receipts from transactions and activities in the course of the regular trade or business that produce income.

In general, determine sales within Arizona on a destination sales basis.

U.S. government sales are Arizona sales if shipment of the property is from an office, store, warehouse, factory, or other storage place in Arizona. If the taxpayer is not taxable in the state of the purchaser, the Arizona sales include the property shipped from an office, store, warehouse, factory, or other storage place in Arizona.

*NOTE: Multiply the amount entered on line C3(e), column (a) of the Schedule C (the total Arizona sales) by 2 (double weighted sales factor) on line C3(f), column (a). Enter the amount on line C3(g), column (a). Do not double the amount on line C3(g), column (b) of the Schedule C (the everywhere sales of the taxpayer). Example: The S corporation has total Arizona sales of \$100,000 and total everywhere sales of \$1,000,000. On line C3(g), column (a), enter \$200,000 of Arizona sales. On line C3(g), column (b), enter \$1,000,000 of everywhere sales for the S corporation.*

The sales factor ratio on line C3(g), column (c) may, in certain circumstances, exceed **100** percent. However, since the total ratio (line C4, column (c)) is divided by four, the average ratio (line C5, column (c)) will not exceed **100** percent.

### Line C5 - Average Ratio

Divide the total ratio, line C4, column (c) by four. Enter the average ratio here and on page 1, line 7. Express the ratio as a decimal carried out to six places.

*NOTE: Do not exclude a factor from the total ratio (line C4, column (c)) if the numerator of a factor is zero and the denominator of a factor is greater than zero. However, the taxpayer must exclude a factor if both the numerator and the denominator of a factor are zero. If the property or payroll factor is excluded, determine the average ratio (line C5, column (c)) by dividing the total ratio by three. If the sales factor is excluded, determine the average ratio by dividing the total ratio by two.*

## Information on Shareholders

Complete all information requested on each shareholder. List each shareholder's name and address, social security number, trust's federal employer identification number, percentage of ownership, distributive income or loss. Check the box if the shareholder is a nonresident of Arizona. Attach additional sheets if needed.

### Resident Shareholders

Resident shareholders are taxable on their entire distributive share of income from the S corporation. The distributive share of S corporation income reported on the federal return will flow through to Arizona Form 140 or Arizona Form 141.

### Nonresident Shareholders

Nonresident shareholders of S corporations operating in Arizona are subject to Arizona income tax on their distributive share of the income (loss) earned by the S corporation in Arizona. See Schedule K-1(NR). Nonresident shareholders must file Arizona Form

140NR, Nonresident Personal Tax Return, to report this income (loss). Estates and trusts must file Arizona Form 141, Fiduciary Income Tax Return.

## Schedule K-1(NR) - Instructions for the S Corporation:

Use this schedule for all nonresident individual shareholders and nonresident fiduciary shareholders.

Any S corporation that has income from business activity that is taxable both within and without Arizona must allocate and apportion its net income. The S corporation must allocate and apportion its income according to the Uniform Division of Income for Tax Purposes Act (UDITPA), ARS §§ 43-1131 through 43-1150. An S corporation that has income from business activity taxable in more than one state is a "multistate S corporation". An S corporation that has income from business activity that is taxable entirely within Arizona is a "wholly Arizona S corporation".

### Column 1 - Distributive Share Amount

Wholly Arizona S corporations - In column 1, enter the distributive share amount for each line item from the federal Form 1120S, Schedule K-1.

Multistate S corporations - Apportion all business income of a S corporation by use of the apportionment formula. Nonbusiness income of a multistate S corporation is nonapportionable and specifically allocable to a particular state.

In column 1, enter the nonresident shareholder's distributive share of the multistate S corporation's income (or loss) that is subject to apportionment. The multistate S corporation must compute the nonresident shareholder's distributive share of the S corporation's income that is subject to apportionment. Make this computation by subtracting the shareholder's distributive share of the multistate S corporation's nonbusiness income from the shareholder's total distributive share amount of the S corporation's income. To compute the amount of such income that is subject to

apportionment, the multistate S corporation must attach a schedule that details (for each line item):

1. The shareholder's distributive share amount from the federal Form 1120S, Schedule K-1.
2. The shareholder's distributive share amount of the S corporation's nonapportionable or allocable income.
3. The shareholder's distributive share of the S corporation's income that is subject to apportionment. Refer to ARS §§ 43-1134 through 43-1138 for the methods of allocating certain types of nonbusiness income.

### Column 2 - Arizona Apportionment Ratio

Wholly Arizona S corporations - Enter 100 percent. **Multistate S corporations** - Enter the average ratio amount from Arizona Form 120S, Schedule C, line C5, column (c), on Arizona Form 120S Schedule K-1(NR), column 2.

### Column 3 - Arizona Source Income

Wholly Arizona S corporations - Multiply column 1 by column 2 and enter the result in column 3.

Multistate S corporations - Attach a schedule that details (for each line item) the following computation:

1. The shareholder's distributive share of the S corporation's income subject to apportionment multiplied by the average ratio in column 2.
2. The shareholder's distributive share of the S corporation's income (or loss) which is specifically allocable to Arizona.
3. The total of the amounts computed in steps 1 and 2 that is to be entered in column 3.

*NOTE: ARS §§ 43-1134 through 43-1138 specify the methods for allocating certain types of income to Arizona. Do not include the amount of any nonbusiness income which is allocable to another state in the total to be entered in column 3.*



All S corporations - Column 3 is the shareholder's Arizona source income from the S corporation. Shareholders should refer to the Arizona Form 120S Schedule K-1(NR) instructions for information on completing their Arizona tax returns.

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### **Information on the Filing of Composite Returns on Arizona Form 140NR**

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Arizona law requires an individual resident or nonresident to file his or her own income tax return. The Arizona Department of Revenue will accept a composite return on Arizona Form 140NR for qualifying nonresident individual shareholders of an S

corporation. *However, a composite return cannot be filed with fewer than ten participating members. Refer to Arizona Individual Income Tax Ruling ITR 93-14 for information regarding the requirements for filing a composite return on Arizona Form 140NR. Call one of the Taxpayer Information and Assistance numbers listed on page 1 of the instructions to obtain a copy of the tax ruling.*